

**Econ 3320 / Prof. Keith Finlay**  
**Problem set solutions**  
**May 5, 2015**

1. Consider our discussion of blight and urban depopulation. Explain three of the policies for mediating urban decline when population density falls. What economic problem does the policy solve (or what economic phenomenon does it exploit), and how does it accomplish this?

- Redirection of public services to discourage development in abandoned areas
  - Helps alleviate the increased fiscal burden of a lower population density city. Provides a disincentive for individuals to locate in low-density neighborhoods.
- Land Banking
  - Helps reduce coordination problems by aggregating vacant land. Might also reduce uncertainty.
- Lot Next Door
  - Gives neighbors first option to buy property. Helps internalize neighborhood externality. Neighbor is more likely to maintain property since they receive much of the benefit.
- Private provision of public goods
  - Alternative to the fiscal problem created by low population density. Still have freerider problem, so this will tend to work where compliance of contributors is forced or easily observed.
- Cluster New Orleans
  - Effort to move returners to higher density clusters. Higher density helps with the fiscal problems, and generates agglomeration economies.

2. In a large city, employers with similar skill demands can share a labor pool. Explain precisely the benefits of a labor pool (relative to an isolated site) from the perspective of employers and employees.

For employers. In years of high demand, there is greater profit because of lower wage and more workers. In years of low demand, there is less profit because of higher wage. But the good news dominates bad news because firms can respond to changes in demand. In high demand, the firm can hire more workers to exploit relatively low wage. In low demand, the firm can hire fewer workers to cushion blow of high wage.

For employees. In our model, expected wages were equivalent in labor pools. Labor pools are also lower risk.

3. Explain why the efficient level of crime is not zero.

At zero crime, the costs of crime prevention likely outweigh the victim cost of crime. The optimal amount of crime occurs where the social costs have been minimized, which is where the prevention costs equal the victim costs.

4. Explain the ways in which government policy accelerated or contributed to urban decentralization in the US during the 20th Century.

- FHA: reduced costs for long-term mortgages, thereby increasing demand for housing; also increased relative preference for low-density, single-family housing
- Interstate Highway Act and other highway subsidies: reduces commuting cost for households living in peripheral communities
- Price distortions for car travel: same as above
- Underpricing of fringe infrastructure: reduces relative price of peripheral locations